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COMMITTEE ON NEBRASKA RETIREMENT SYSTEMS
February 3, 2005
LB 494, 503

The Committee on Retirement Systems met at 12:15 p.m. on Thursday, February 3, 2005, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB 494 and LB 503. Senators present: Elaine Stuhr, Chairperson; John Synowiecki, Vice Chairperson; Patrick Bourne; Phil Erdman; Don Pederson; and Marian Price. Senators absent: None.

SENATOR STUHR: We want to begin the hearing this afternoon for the Nebraska Retirement Systems Committee. And I'd like to do some introductions. And to my far right is Mr. Don Jones who serves as the committee actuary; Senator Marian Price from Lincoln, representing the 26th district; and Senator Bourne, I know will be joining us. He is not here at this time. District 8, Senator Bourne is just walking in right now. Jason Hayes, our legal counsel. I am Elaine Stuhr and I serve as Chair of the committee. And to my left is the Vice Chair of the committee, Senator John Synowiecki from Omaha, and Senator Phil Erdman from Bayard, and Senator Don Pederson, who serves as Chair of the Appropriations Committee, so we're happy to have him and our committee clerk, Kathy Baugh. Just a few rules. Please turn off your cell phones or any pagers that you might have. Those wishing to testify, we would appreciate if you come towards the front of the room. Be sure to print your name and identify yourself when you do come up to testify and spell your name. This is always important for the transcribers who have to work on the transcripts at a later time. If you have handouts, give them to the page, and Matt Rathje is serving as our page, and he comes from York, Nebraska, and is attending UNL. So we thank him for helping us out today. I believe that's it. We will hear from proponents of the bill and then opponents and then those wishing to testify in a neutral capacity. So we will open this afternoon on LB 494 and I will turn the proceeding over to our Vice Chair, Senator Synowiecki.

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SENATOR SYNOWIECKI: Thank you, Senator. Senator Stuhr will open on LB 494.

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SENATOR STUHR: (Exhibit 1) Good afternoon, Senator Synowiecki and members of the Retirement Committee. For the record, my name is Elaine Stuhr, S-t-u-h-r, and I represent the 24th Legislative District. I'm here today to introduce LB 494. And this proposal would create an additional fund selection category for members participating in both the state employees and the county employees Defined Contribution Benefit Plan. This new investment option for non-cash balance members would permit employees to invest their retirement dollars in an asset allocation mix that is similar to the portfolio mix used for the defined benefit plans. The monies deposited by employees into this fund would be invested under the direction of the state investment officer, with an asset allocation and investment strategy substantially similar to the investment allocations made by the state investment officer for the defined benefit plans, which include the school employees, the judges, and the State Patrol. Although there would be no guarantee of benefits as is typical in the defined benefit plan, this new fund would allow employees to take advantage of the investment management decisions made by the Investment Council, including the choices the council makes when it determines the investment selections for the defined benefit plan. Let me give you an example of how this could benefit these members. In 2003, the defined benefit portfolio had a 23.6 percent investment return. In contrast, for employees in the defined contribution plans they could choose between 11 different investment funds that provided a return anywhere between 51.4 percent for the small cap fund to a 1.1 percent return for the money market fund. Depending on the selections made, it is up to the employee to pick the right funds in order to provide a suitable benefit during retirement. Some employees make good selections and retire with adequate benefits, while some employees lose, depending on which funds they select. However, if there was an investment choice as proposed in LB 494 that mirrored or was similar to what the Investment Council selects, then employees could hopefully benefit from the same investment advice that the council receives when it makes investment decisions. The investors select account would consist of investments including both domestic and international equities, fixed income investments, real estate, and other additional asset classes as determined by the state investment officer. Although it should be noted that even

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with the passage of LB 494, employees will still have the ability to choose other funds that may or may not bring a better rate of return. At least there would be an alternative choice that could continually be improved based upon the decisions made by the Investment Council. Also there is a technical amendment AM 0213 that I will submit to the committee based upon the legal counsel's recommendation. Are there any questions that I might address?

SENATOR SYNOWIECKI: Thank you, Senator Stuhr. Senator Erdman.

SENATOR STUHR: Yes, right.

SENATOR ERDMAN: Senator Stuhr, in regards to the technical amendment, as I read what we're doing with LB 494 is we're expanding an investment opportunity and we're outlining what those opportunities are. The current language says that they're not limited to these opportunities and even though we are adding this additional option, if they're not limited to these what other options are available specifically outside of these examples?

SENATOR STUHR: I believe they have a combination of 11 different choices and we are adding this additional one, but I may stand to be corrected.

JASON HAYES: There are more investment funds that you can choose than what are listed in statute, so you need to leave that "limited to" out or you can leave it back in statutes.

SENATOR ERDMAN: I guess a process question, Madam Chairman, then, why do we list any of them if...isn't the idea under state law to grant authority and then use that authority under law to be able to exercise the rights granted and if we're...I guess we can discuss this, but I just have a question about why they're not all listed or if there's a good reason or maybe Ms. Kontor can answer that.

SENATOR STUHR: All right, okay. All right, thank you. Yes.

SENATOR SYNOWIECKI: Senator Pederson.

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SENATOR D. PEDERSON: Senator Stuhr, at whose request did you submit this proposal? Is it the Bankers Association?

SENATOR STUHR: No, no.

SENATOR D. PEDERSON: Oh.

SENATOR STUHR: I believe it was just individuals who are in the defined contribution plan and looked at it as another option.

SENATOR D. PEDERSON: Well, under the way in which they administer these plans there's a certain charge for doing so, is there not?

SENATOR STUHR: I...

SENATOR D. PEDERSON: A percentage charge.

SENATOR STUHR: ...I believe maybe Ms. Sullivan might be able to identify that.

SENATOR D. PEDERSON: Okay. Well, you talked about a 1 percent return. I just didn't see any great benefit in somebody putting their money into a 1 percent return and then paying an administrative charge.

SENATOR STUHR: Right.

SENATOR D. PEDERSON: Okay.

SENATOR STUHR: I believe you might address that question to her.

SENATOR D. PEDERSON: Okay, thank you.

SENATOR SYNOWIECKI: Any other questions? Thank you, Senator Stuhr.

SENATOR STUHR: Yes. Thank you.

SENATOR SYNOWIECKI: Proponents, please. Proponents of LB 494 testimony?

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CAROL KONTOR: My name is Carol Kontor, K-o-n-t-o-r. I'm the State Investment Officer, and I'm here today on behalf of the Nebraska Investment Council. For plan participants in the state and county retirement plans who did not select the cash balance benefit and for employees in the current state deferred comp plan there are 11 investment options available to them. It is understandable that some of these members are uncertain as to which options to choose, don't want to spend the time monitoring or rebalancing their investments or just prefer to have someone else manage their money for them. For these people, the investors select option proposed in LB 494 may be an appropriate alternative. They would basically be selecting the Investment Council to manage their money in a manner substantially similar to how the council invests the assets in the defined benefit plan and the cash balance benefit. The Investment Council understands the reasoning for adding this option and supports the bill. However, I would like to take a few minutes to discuss implementation of the investors select fund, if LB 494 is passed. The investments in the defined contribution option are daily priced so that a participant has daily liquidity for fund transfers. Some of the asset classes and investment managers used for the defined benefit and cash balance benefit do not have a daily-priced product. Thus, it is important that it be understood that if passed, the Investors Select Fund would be substantially similar, but not identical, to the assets in the defined benefit and cash balance benefit. There are some critical items that we could get close to identical, such as the overall asset allocation between U.S. stocks, international stocks, bonds, real estate, and also the percentage of active versus passive in the various asset classes. But there are a couple of notable areas where we could only invest in a similar manner. For example, for some active managers that do not have a daily-priced product, we would use our best efforts to find a substantially similar manager who does have a daily-priced product. Also, the council recently allocated a small percentage of the defined benefit and cash balance benefit assets to private equities. Because of the nature of this asset class, there is no comparable daily-priced product, and we would need to use some publicly traded investment to mimic, as best we can, this allocation. In summary, we support the addition of the investors select fund but want to be clear that it would be substantially

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similar to the defined benefit and cash balance benefits, but not identical. We would do the best we reasonably can to have the investors select fund mirror these other investments. Thank you and I would be happy to answer any questions. And I might...just on the couple that have been brought forth before, we do have additional investment options, including the ones that are listed in the bill. Say, for example, it talks about we have to have a fund like the S&P 500. In addition, we have a large growth stock index, a large value stock index. We do have a couple of fixed-income options, so that's what makes up the 11 options in addition to those that are just cited there. Now, regarding the process whether you should list any, when it's not all-inclusive, I'd turn that over to the lawyers. The other thing about the 1 percent, I think what Senator Stuhr was referring to was, depending on which of those 11 you chose, that's how you got that big range of possible rates of return. So you might have been in...I think it was, well, the money market fund for the one year earned 1 percent. So if you were in the money market, if you had all of your money in the money market fund then that's what you would have gotten. Now that is net of fees, these numbers that we're quoting are net of fees. The fees in these index funds, they're netted out before we're quoting rates of return, so I'd be happy to answer any other questions.

SENATOR SYNOWIECKI: Questions of Ms. Kontor? Senator Erdman.

SENATOR ERDMAN: Just making sure (laugh). Ms. Kontor, I'm trying to understand how this works. Your explanation of the previous question that I'd asked the chairperson was that there are different accounts under each one of these areas, say, an index fund account. There are different options under a fixed income account, there are different options. So generally, the 11 accounts are based on the options that are here. Is that accurate?

CAROL KONTOR: Not quite. For sure, because this is in statute, we definitely offer these. In addition, the council has decided to offer others.

SENATOR ERDMAN: What authority does the council have to

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make those offers outside of statute? I mean, is there a statute somewhere that says that the Investment Council has the authority to determine other appropriate investment options, as they see fit or is the options that the Investment Council has to choose from, solely based on the state statutes that grant them the authority to operate under?

CAROL KONTOR: Well, I don't think, we don't believe that we're in conflict with the statute because of this, "but not limited to" or "shall include" doesn't mean that it's an all - inclusive list. Now the development of these is historical, has a long track history and probably because Anna has been here a lot longer than I have, she's probably going to know that history better than I do.

SENATOR ERDMAN: So essentially, the current language it's in 23-2309.01 says, because it says "but not limited to" the Investment Council has the discretion to set up any other funds in addition to the ones that are mandated here.

CAROL KONTOR: We would believe that, yes, that's correct.

SENATOR ERDMAN: So that's where your grant of authority comes from.

CAROL KONTOR: Um-hum, right. That's what we would think, yes. And in addition, the State Funds Investment Act names the council as fudiciary for these plans, so that if there would be a glaring omission that for some reason, you know, some different investment asset class came out and we thought it should be there as a fudiciary responsibility, we would feel that we needed to offer it.

SENATOR ERDMAN: Okay, thank you.

SENATOR SYNOWIECKI: Any other questions for Ms. Kontor? I have a question.

SENATOR D. PEDERSON: Go ahead.

SENATOR SYNOWIECKI: The investors select account then under old language replaces what...if a member fails to...I'm going to page 3 of the bill, in old language, if a member

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fails to select an option or combination of options all but his or her fund shall be placed in the option described in subdivision (a), which now becomes the investors select option or account. Which of those two, which was formerly (a), the stable account, embodies a higher risk low?

CAROL KONTOR: It depends how you define risk. If you have a one-year-old child and you're saving for them or you're 40 years away from retirement, I think your risk is to be in the stable value fund. If you're two years away from retirement, then you would have more risk in the defined benefit because there would be more equity than stable value. So it's whether you're talking about market risk or inflation risk.

SENATOR SYNOWIECKI: Okay. Because I think the intent of the old language was to put them into a lower risk category. And are we now, for those that fail to select an option, are we by virtue of this bill going to put them in a little bit of market...when I speak to risk I'm speaking of market risk...

CAROL KONTOR: You're talking about market risk.

SENATOR SYNOWIECKI: Are we then going to put them in a little bit higher risk category for those those that don't select?

CAROL KONTOR: Yes, yes. There is more market risk in what the Council does than in a stable value fund, yes.

SENATOR SYNOWIECKI: Would you agree the intent of the old language was to put them in the lowest risk category possible relative to market risk for those that are not engaged in the retirement plan, as far as selecting an option?

CAROL KONTOR: Yes, I think that was the intent. What unfortunately happens then is like and I'm looking at the individual options. There are eight individual options. Of those eight, the option with the highest dollars is the stable value fund. And then that's why some of these...and the stable value fund returned the five years ending September 30, it returned 6.1. Last year for one year, it

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was 4.5, so if you're a 30-year-old employee, 35, 40 I don't know, at some point...well, and even these days the investment theory would say even if you're a 65-year-old employee, you shouldn't be all in fixed income because if you're going to live another 25, 30 years you still need to be taking equity risk. So I know that NPERS works very hard to try to get people out of the stable value fund because it has been a default fund and for many employees is not appropriate...

SENATOR SYNOWIECKI: So it is...

CAROL KONTOR: But in answer to your question, it does have market risk.

SENATOR SYNOWIECKI: So it is your intent to move that from a default fund to the investor class fund. This new fund, under LB 494, that is your intent then or the intent.

CAROL KONTOR: That is the intent of the bill.

SENATOR SYNOWIECKI: Okay, thank you. Senator Pederson.

SENATOR D. PEDERSON: Well, I was just thinking in terms, we ordinarily consider retirement funds as looking for what we would call safe investments for people. And let me just ask you, in that respect you're, from answering Senator Synowiecki's questions, this is opening up more opportunities for more less conservative investments. Isn't that true?

CAROL KONTOR: Well, it would be more conservative than one of the pre-mixes. Right now there are three pre-mixes. This would be a fourth one. And it slides in between the moderate pre-mix and the aggressive in terms of equity allocation.

SENATOR D. PEDERSON: Okay. And just in general terms, what would you say was the positive aspect for this proposal and either from the retirement beneficiary's standpoint or from your standpoint as administrator of the investment funds, what are the down sides to this bill?

CAROL KONTOR: What the positive standpoint, I believe the

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positive standpoint is that for those people, and I bet this is probably the majority, who don't spend a lot of time understanding the investment options, don't spend a lot of time rebalancing. If they get into the S&P 500 because it was great in 1999, which it was, they maybe get too much into it. You know, it's very hard even for people that are in this business all the time to buy on bad news and sell on good news. There is...momentum investing is a real problem for the average person. So I think people don't spend very much time, are confused by it, and this gives them the option to have somebody else manage their money for them, so I think in that way it's a plus. And it's an optional plus. If somebody says I want to be in the stable value it will continue to be an option. It isn't a mandatory option. The negative is, if a person gets to be close to retirement, they shouldn't be maybe a hundred percent in this. You know, they should be starting to have more fixed income than equities as they get closer to retirement. But that would be the same thing whether they're in S&P 500 or not because this is going to be...the accounts right now were 50 percent U.S. equities, 15 percent international equities, 30 percent fixed income, and 5 percent real estate. And then, within each one of those asset classes were diversified growth and value and large cap and small cap. And so we're diversifying within the asset class, and so you have some diversification, but I understand that as you get closer to retirement the market volatility is more distressing.

SENATOR D. PEDERSON: Okay. From that standpoint then, I'll come back to another aspect, but from that standpoint. Is there someone that counsels with these investors to alert them to the concerns and as they're aging...you know, I understand that generally when people are younger they can take a little more aggressive position. As they get older, perhaps they'd want to be more conservative. There's always a tendency to chase yesterday's big funds, isn't there?

CAROL KONTOR: Yes, yeah there is, yeah.

SENATOR D. PEDERSON: And particularly some people as they get older would think if they don't quite have enough, maybe they better get into that because it was real good yesterday. And it's kind of the buy high, sell low stock club that they get into.

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CAROL KONTOR: Right, right. In Anna's area with NPERS. They do a wonderful job of education. The problem is getting the people there.

SENATOR D. PEDERSON: Yeah. Well, that's...

CAROL KONTOR: I know she's always trying...you know, the group is always trying to beat the bushes to get everybody to...

SENATOR D. PEDERSON: Well, I'm thinking about the individual investor.

CAROL KONTOR: Um-hum.

SENATOR D. PEDERSON: You know, I'm trying to make calculated decisions, and it doesn't always work real well. But you alluded, in your testimony, to some difficulties in actually figuring day to day investment value for these stocks. Is that one of the down sides from your standpoint-- administering?

CAROL KONTOR: Well, it's...I believe it won't be a problem to get it substantially similar. You know, there are just...I wanted to be sure that everybody understood it wouldn't be identical. But, you know, there are plenty of daily priced funds, and so we would be able to implement it substantially similarly. The issue of daily pricing, just by itself is another issue because that just facilitates selling high, buy...or you know, buying high, selling low, yeah. So, but that's a different issue.

SENATOR SYNOWIECKI: Senator Bourne.

SENATOR BOURNE: Thank you, Senator "Synowhisky." Do you know, of those individuals who have the ability to select which fund, you know, direct the array of their investment, how many of our members actually select and how many do it by default?

CAROL KONTOR: I don't know, I don't know that. Anna would have that.

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SENATOR BOURNE: Okay. I think it's a real small percentage of those that actually select, and most of them go into default.

CAROL KONTOR: I think that's correct.

SENATOR BOURNE: So based on what Senator Synowiecki or Senator Pederson were saying, so it seems to me that the majority of our investors are going to go into the default fund. And as I understand it, the default fund is more of a higher risk, as proposed, than we have traditionally done.

CAROL KONTOR: Market risk, yes, um-hum.

SENATOR BOURNE: Market risk. Is there any...okay, and then you have the component. And I absolutely agree with you that Ms. Sullivan and her crew do a fantastic job on educating people, as much as they want to be educated.

CAROL KONTOR: Right, right.

SENATOR BOURNE: But I guess what I'm wondering is, so we as a state are going to say that this bill, the policy of the state would be to steer those who basically pick the default into a more higher risk array, is there any fiduciary liability on behalf of the state, if we don't then steer them back when it's appropriate, from an investing standard, to do so? Do you see where I'm coming from?

CAROL KONTOR: I do.

SENATOR BOURNE: Okay.

CAROL KONTOR: I do and it defines the role of the state, the employer whether it's the state or a corporation, what is their role in these 401k plans or this kind of a plan, a state plan?

SENATOR BOURNE: Right.

CAROL KONTOR: Because, you know, and there would be other ways to do this, you know, would be to change that default option if that's problematic. You know, you want to be argumentative. I mean, on the same hand we could say, what

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is our role in terms of allowing 30-year-olds to go into the stable value fund? You know, and then they end up with an inadequate retirement but...

SENATOR BOURNE: Yeah, and you can be argumentative all you want, but I absolutely value your opinion and that's, you know, we're trying to flesh out. But it just seems to me that if all of a sudden we're saying it's the policy, the majority of our investors who select the default, who just don't feel comfortable enough to make a decision, I think is what it all boils down to. We're steering them into a higher market risk array of funds. I'm just wondering if we're going to assume some sort of maybe not legal responsibility, but maybe there's a moral responsibility, if we don't steer them back, when they become 55 or 60. And then we have the market downturns like we did...I mean, I just think the potential for a whole lot of people, if the moon and the stars align, to be without a retirement is pretty significant. Please let me know what you think.

CAROL KONTOR: Um-hum, um-hum. Well, I mean and that is, you know, that is the other side of putting them in something that is more, that has equity risk. That's the plus and the minus of equities. Yeah.

SENATOR BOURNE: Thank you. And again, I appreciate what you do. I would imagine the retirement members sleep well at night knowing that you're at the helm there. So I think you're doing a fantastic job. Thank you.

CAROL KONTOR: Well, thank you. We have a great council, and the Nebraska Investment Council is really composed of excellent people, and I hope you all know the degree to which they're working very hard to accomplish these objectives.

SENATOR BOURNE: Thank you.

SENATOR SYNOWIECKI: Any other...Senator Stuhr.

SENATOR STUHR: Yes. Could you just go over a little bit of what we are actually proposing is a portfolio similar to the defined benefit? And I believe we indicated that that does seem to have a higher percentage of return. Is that

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correct?

CAROL KONTOR: Yes. The history was, you know,...

SENATOR STUHR: The portfolio.

CAROL KONTOR: ...the old thing about the past is no predictor of the future...

SENATOR STUHR: Right.

CAROL KONTOR: ...having made that caveat, then just as the defined benefit has been doing better than the average defined contribution investor that may continue in the future. So this would be the addition of a twelfth option and basically to mirror what the council does for those people that want to choose that. Because right now we do have three pre-mixes. We have the conservative pre-mix, which is 25 percent equity 75 percent fixed income. Then we have the moderate pre-mix, which is 50 percent equities 50 percent fixed income. This would be 65 percent equities 35 percent fixed income. And then we also currently have the aggressive pre-mix, which is 75 percent equities 25 percent fixed income. So this slides between the moderate and the aggressive. But if the council changed that for some reason, then it would change automatically. We would feel it was our responsibility to change this. Let's say for some reason we went to 60 or 70 percent equities. We would have to change this one then as well.

SENATOR STUHR: Okay. All right. Thank you for that clarification.

SENATOR SYNOWIECKI: Any other questions from the committee? Thank you for your testimony. Other proponents? Proponent testimony. How about opponent testimony, those in opposition?

SENATOR STUHR: Oh, excuse me, this was a letter that should have been read in for proponent.

SENATOR SYNOWIECKI: (Exhibit 2) Senator Stuhr has alerted me to a letter that we've received from the Nebraska Association of Public Employees in support of LB 494 and

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LB 503 which will be made part of the record. Any neutral testimony?

ANNA SULLIVAN: Good afternoon, Senator Synowiecki and members of the Retirement Committee. My name is Anna Sullivan, S-u-l-l-i-v-a-n, director of the Nebraska Public Employees Retirement System. The retirement board didn't take a particular position for or against this bill. I think that some of the questions that you have, I think, were questions that we would probably have. I did appreciate the discussion that you had with Ms. Kontor, but also one of my questions was a technical question or issue that we would have to work out would be the daily pricing of an account because we do have a recordkeeper who, on all of our investment options every night, has to get a price before the market closes to establish the unit value in each member's retirement account. And there are, of the defined contribution members, I think we're about 11,000 defined contribution members within the state plan. I don't know my county numbers right off the top of my head, but I happened to just look at the state employees. But certainly from our viewpoint, we would take on the responsibility for educating to make sure everyone understood the risk. The only thing I would point out in listening to some of your discussion and your questions is that what is not included in your copy of LB 494 is the section where the employer contribution occurs and the employer contribution up until just recently defaulted to the moderate which was the...or version of the balanced fund which is on line 22 of page 2. The balanced account shall be invested by...and those balanced accounts there's three that Ms. Kontor referred to. We call them pre-mix. The 75, 25, the 50, 50 and the 25, 75. And the moderate is the middle 50, 50. And that's been the default for the employer match up until just this past year, when now the employer dollars have all of the array of options, so the employee can select or direct the employer match among those 11 choices. And we work very hard at trying to educate our plan members to understand the investments. But I don't think sometimes it's a lack of understanding, I think it's a lack of time. I think it's, you know, they're busy like you're busy. You're doing your job every day. How much time...when you go home at 10 o'clock at night are you going to be thinking about where you're going to put your money in your retirement account? I mean, it's a time

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issue. That's my concern, and so we do try to help heighten their awareness but, at any rate, I'd be happy to answer any questions. And if you decide to go forward with this, we'll certainly work with you and work with Carol and the Investment Council to incorporate this into our education and our information we distribute to employees.

SENATOR SYNOWIECKI: Thank you for your testimony. I would be interested as followup to Senator Bourne's question relative to the percentage of members that do not...that are disengaged and do not select anything and go to the default mechanism.

ANNA SULLIVAN: Like Ms. Kontor said, if you look at just the dollar value of the asset, when you just see where the money sits, that's a pretty good indicator. There's a lot of money that's in the stable value fund. This whole process of investment choices has evolved. It first really became available in the mid-eighties, and we only had three funds. And so what I look at, Senator Synowiecki, is I'll see those original three funds, the stable and a growth and a balanced. Those original three funds have a higher allocation than all the new ones we've added since the early nineties. So there's this kind of inertia I think is what happens. But I can't tell you an exact number right now. We could probably track that because we would have access to those transactions through our recordkeeper.

SENATOR SYNOWIECKI: How much of an administrative headache would it be, or would this be possible, that we had kind of a tiered system for the default fund? And what I'm thinking here is those members under 50 years old, their default fund is A. Those members that are in excess of 50 years old, their default fund is B. And we can even take this to another level, those that are under 30 years old, for example, their default fund. And while the members, for whatever reason, don't want to be involved in the decisionmaking in the retirement; as a state, perhaps we could kind of provide some type of guidance so that the retirement benefit when it comes to retirement is as great of a benefit as is possible within the parameters of the decisionmaking.

ANNA SULLIVAN: We certainly could accommodate, I believe,

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those kinds of age-based funds. I think you might want to talk to your legal counsel as to whether there might be issues if they're age-related, whether there would be any questions...that's the first thing that popped in my head is whether somebody over 50 were required to be directed into a certain kind of fund, whether that would raise an age question.

SENATOR SYNOWIECKI: No, it wouldn't be required. It would be if...

ANNA SULLIVAN: Oh, optional.

SENATOR SYNOWIECKI: ...if they do not select...

ANNA SULLIVAN: Oh, yes.

SENATOR SYNOWIECKI: ...the default fund associated with each member would be dependent upon their age.

ANNA SULLIVAN: Sure. I mean we certainly...that would be because...

SENATOR SYNOWIECKI: Let me be clear. When you say default fund you're saying for those members that are not making any decisions.

ANNA SULLIVAN: That's correct. Their dollars are contributed, their first contribution comes in. We have no investment allocation form from them, it goes into the default. And we may not ever get an allocation from them.

SENATOR SYNOWIECKI: And that default fund may not be in the best interest of a 27-year-old state employee.

ANNA SULLIVAN: That's correct.

SENATOR SYNOWIECKI: And vice versa, it may not, the default fund, whatever it may be, may not be in the best economic interest of a 57-year-old state employee.

ANNA SULLIVAN: That's correct.

SENATOR SYNOWIECKI: Any other questions of Ms. Sullivan?

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SENATOR BOURNE: Just one quick one. Thank you. I don't see an emergency clause on the bill, so that means if it passed it would go into effect sometime late summer. Does that give you enough time to amend your informational material to...?

ANNA SULLIVAN: Sure. We would really follow the Investment Council as they create the fund. We'd follow them. Once they have a description of who...

SENATOR BOURNE: But six months would be enough time for you to get...?

ANNA SULLIVAN: Oh, I think so.

SENATOR BOURNE: Okay.

ANNA SULLIVAN: But I guess Carol, you know, she would have to take the lead, and then once she has her fund designed, then we would write material to describe that to our members and incorporate that.

SENATOR BOURNE: Okay. Thank you.

ANNA SULLIVAN: Um-hum.

SENATOR SYNOWIECKI: Any other questions of Ms. Sullivan? Senator Stuhr.

SENATOR STUHR: Yes, just a clarification. I think there was a question in regards to fees in selecting, you know, different choices. So could you just address that real briefly?

ANNA SULLIVAN: On all of our defined contribution accounts there are operational fees that are provided for. One, there is the recordkeeping fee, but let me start first with the banking, the custodial bank fee. We gave a report to the employees not long ago about that. There's a custodial bank fee that comes off of the unit price of the plan member. There's also the expenses that Carol's office incurs. There is a management fee that the company, you know, the investment management company whoever they are,

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XYZ company, that they charge for managing the asset. And those have been the traditional fees. We have a recordkeeping fee that's a flat dollar amount that is assessed to pay our recordkeeper who is not a...it's not a state entity. It's an outside company that we contract with and that recordkeeping fee is a dollar amount, as opposed to a percentage charge against the unit price. There has also been a ten basis points charge, ten basis points...I could show you how that's calculated. But a ten basis points charge that was, began to be assessed in July of 2003 to cover our expenses in the retirement office due to the forfeiture account being depleted. And so, but generally, I think all in the last number I've seen was 29 basis points is being charged on average for every state and county and deferred comp employee for the management. And that's not 29 percent, that's .29 percent, if you understand what I'm saying.

SENATOR SYNOWIECKI: Any other questions from the committee? Seeing none, thank you for your testimony.

ANNA SULLIVAN: Okay, thank you.

SENATOR SYNOWIECKI: Any additional neutral testimony relative to LB 494? Seeing no other testifiers, Senator Stuhr to close.

SENATOR STUHR: I'll waive closing.

SENATOR SYNOWIECKI: Senator Stuhr waives closing and the public hearing for LB 494 is concluded and the chair will be reoccupied by Senator Stuhr.

SENATOR STUHR: Thank you, Senator Synowiecki. We will now open the hearing on LB 503 and legal counsel will give that opening. You may proceed.

LB 503

JASON HAYES: (Exhibit 3) Good afternoon, Senator Stuhr and members of the Nebraska Retirement Systems Committee. My name is Jason Hayes, H-a-y-e-s, counsel for the committee, and I'm here to introduce LB 503. This bill proposes to

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make a number of changes to the operation of both the Nebraska Public Employees Retirement Board and the Nebraska Investment Council. First, LB 503 would require the director of NPERS to carry out random testing procedures in order to verify the accuracy of employee information submitted by employing agencies and political subdivisions included within each retirement system. Currently, such sampling is discretionary on the part of NPERS. But according to recent audit reports, the State Auditor has indicated that such sampling procedures need to be increased. By requiring NPERS to conduct random testing audits, this should help ensure that employers will do a better job in providing accurate information if the employers know that NPERS is taking additional steps to verify such information. Next, LB 503 would increase the required financial and investment experience necessary in order for an individual to be appointed to the NIC. It has been suggested that this requirement should be heightened in order to provide a greater level of investment experience prior to a Governor making his or her appointment to the council. This bill would also raise per diem amounts paid to members on both PERB and the NIC. Currently, there is no per diem for PERB members, while there is a \$20 per diem for NIC members. This amount would be raised to \$50 for PERB members and \$75 for NIC members for each meeting. In addition, the bill would make changes to the annual reports filed by both PERB and the NIC. These changes include the type of information provided in each annual report and the timing as to when each report will be presented to the Nebraska Retirement Systems Committee. This provision would also require additional disclosure of investment, administrative, and recordkeeping fees collected by both PERB and the NIC. Such disclosures will give employee members better information regarding the types and amounts of each fee. LB 503 also updates the statutory language describing the process by which the Legislative Council may fund a benefit adequacy study as an expense to the retirement system. And finally, the bill would insert language to outline the duties and responsibilities of the internal auditor employed by PERB. Both the internal auditor and the legal counsel employed by PERB would also be included under the state personnel system. As I noted at the start, LB 503 makes a number of changes to both PERB and the NIC. These changes help address issues raised in prior

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audits, as well as updating certain provisions in order to ensure the continued proper operation of both agencies. And also there is a proposed amendment, AM211, that would delay the implementation of the required testing until January 1, 2006. The amendment would also delay the compliance audit completion date until December 31, 2007. The reason for such delays is to give the agency additional time to implement the procedures. Are there any questions that I may address?

SENATOR STUHR: Are there any questions for Mr. Hayes?
Senator Bourne.

SENATOR BOURNE: Jason, on page 4 of the bill it expands the experience requirement for new members that would be appointed after July 1. What's the basis for expanding that experience level?

JASON HAYES: This is actually a request made by the State Investment Officer and perhaps that question should be directed to her, but it's my understanding that the greater level of experience on the council would relate or hopefully help in them making better investment decisions.

SENATOR BOURNE: Good, thank you.

SENATOR STUHR: Are there other questions? Okay, thank you. Proponents for the bill, please come forward. Welcome.

HERB SCHIMEK: Ms. Chairman, members of the committee, my name is Herb Schimek, S-c-h-i-m-e-k, here representing the Nebraska State Education Association in favor of LB 503. We think the per diem is justified, and we fully support that. And the other items in the bill also seem to us to be very good. Thank you.

SENATOR STUHR: Okay. Are there questions for Mr. Schimek? If not, thank you very much.

HERB SCHIMEK: Thank you.

SENATOR STUHR: Are there others wishing to testify as proponents of the bill? Welcome.

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CAROL KONTOR: Thank you. Senator Stuhr and members of the Retirement Committee, my name is Carol Kontor, K-o-n-t-o-r. I am the State Investment Officer and am here today on behalf of the Nebraska Investment Council. The Nebraska Investment Council has responsibility for the investment of the assets in three defined benefit plans, the state and county defined contribution options, the cash balance benefit, two state deferred compensation plans, the state's General Fund, state agency money, the Time Deposit Open Account Program, the College Savings Plan of Nebraska, the AIM College Savings Plan, eight different endowments, and five different trusts. The investment objectives for these programs vary considerably and require different investment strategies and structures. In addition, assets in the programs total over \$10 billion; thus, council members take on an awesome and complex task. The voting men and women that serve on the council are appointed by the Governor and approved by the Legislature. You all have done an excellent job approving members who are capable and appropriate for this assignment. We have an outstanding council. I hope that the plan participants understand the brain power and diligence the council expends on their behalf. Section 3 of LB 503 increases the required investment or financial experience of people appointed to the council. The section also states, "There is a preference for members who are appointed to have experience in investment management or analysis." The council believes that given the investment knowledge needed to do its job well, this section is in the best interest of plan participants, and the council strongly supports its passage. Other sections of LB 503 clean up some inconsistencies regarding our annual report to the Retirement Committee and to PERB. The council supports this cleanup to ensure our compliance with state statutes. And if you...and I would be happy to answer any questions. And I know there's one carry-over question about the increase in the number of years. We strongly believe that it would be best to have council members who have investment experience, not just financial experience. That's why there's more financial experience required than investment. But it had been five years of investment experience. We're requesting that be increased a number of years, a couple of years. Two things: it gives you a little bit more experience and it would mean, I hope this isn't, oh, let's see, I don't want to do any age problems here, but in the field of investing,

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experience, years of experience is a good thing because you will have seen strong bull markets and strong bear markets and you have more perspective on which to draw. So we also like someone who has a number of years of experience in the field.

SENATOR STUHR: Okay, thank you. Are there any questions for Ms. Kontor? Thank you for bringing forth those requests and for the good job that you do.

CAROL KONTOR: Thank you.

SENATOR STUHR: Are there others wishing to testify in support of the bill? Those wishing to testify in opposition. Those wishing to testify in a neutral capacity. Welcome.

ANNA SULLIVAN: Senator Stuhr and members of the Retirement Committee, I guess you can count on me for neutral today. Anna Sullivan, S-u-l-l-i-v-a-n. The Retirement Board did not take a position for or against LB 503. I have just a couple of things that I wanted to just mention with regard to the bill. First of all, because of the mandate on the auditing of the schools or the sampling of the schools, we do believe we need to have an additional staff person in order to do that work. We have an internal auditor, as was mentioned in Jason's testimony. The internal auditor's duties that are listed out on page 16 of the bill were the original duties when the internal auditor position was created, I believe, in 1997, and that was in the budget bill. And so those duties are now in statute. But we've used the exact language here to create the position of the internal auditor through the state personnel classification system. But the instructions at that time, the internal auditor was not to be conducting audits on the schools. And we were told that we were not to be auditing the schools by the Legislature. And so the function was to be internal. I think that was the key word. For us to be monitoring the schools, we do quite a bit of monitoring of the schools, and it may not fall under the term "audit" from a technical term. But I'd just like to highlight some of the things that we do do, not to contradict what you're trying to do here, don't get me wrong or don't misunderstand me, but just to...I want you to rest assured that we're not just

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accepting everything that the schools or the state agencies or the counties send into us without question. We take our job very seriously, and I hope you're not concerned about that. I'm not sure. If you are, you know, I'd like to lay your minds to rest just a little bit. We conduct comprehensive training for our employers. The school representatives, we do all-day sessions for them every year in June. We provide them a manual that gives them detailed instructions about how to calculate their retirement deductions. And they have instructions on who's eligible for the retirement program and who is not. And we do spend quite a bit of time on cases, individual cases that come to our attention. We monitor the reporting that the schools submit to us. They give us a lot of information in their monthly reports, automated, I might add, reports, and we monitor. If we see salaries jumping, we've talked about spiking, you know, salaries spiking, if we see salaries inordinately high from one year to the next, that will almost automatically be a trigger for us to go out and investigate. And we do have quite a bit of authority right now in the existing statute to demand from the employers information in an accurate and verifiable form, as specified. We have access to their records, and we do use that quite a bit, especially if we have questions that come up when we're working with a particular file. The other thing that we do is we send out annual statements to our school, judges, and patrol members. And those annual statements serve as a notice to the employee what the employer has reported to us. And that's an opportunity for the employee to be eyes and ears, if you will, and to go to their employer and say, you know, something doesn't look right here. For state and county employees, they get quarterly statements. If there is something amiss, the employee is a good person, the good individual, if you will, to go to their employer and say, hey, you know, this doesn't look right. And I think that's worked pretty well for us. If you remember, those annual statements for the schools used to be certified mail. We wanted to make sure that they had received them and that they were aware of what was being reported by the employer. So there is...if it will put your mind to rest, there is a lot of work that we do right now, and we'd be willing to take on the additional work that's being specified here. We'd hope to be able to automate it. It says "may" right now and you're suggesting it be changed

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to "shall." We wanted to try to do it in electronic format so it's not a lot of labor, man-hours. But it looks like we're probably going to need to have another person to help us do this. And so we ask your support for a fiscal note that we've submitted on LB 503. And the last item I don't want to forget here is, and this may be part of the reason why I'm neutral today is the per diem for the board. We have board members that are plan members that are in pay status when they come to the board meetings. And they do not believe they should receive a per diem. Our state employee rep, our county employee rep, we have a brand new State Patrol rep. If you remember, you just confirmed him. We have a judges rep. Now the judge is retired so he's not...he's getting the retirement benefits. But we have a school employee rep. And it's my understanding all of those plan members receive pay for the time that they...when they come to Lincoln for our board meeting. They get their expenses reimbursed, but this item was discussed at our last board meeting. And one of the members said, you know, I don't feel like I should take a per diem. Now that's totally up, you know, it's obviously up to you; but certainly I think that's deserved...should be mentioned that they're getting paid to be there. So anyway, if you have any questions, I'd be happy to try to answer them.

SENATOR STUHR: Okay. Are there questions for Ms. Sullivan? Okay, all right, thank you.

ANNA SULLIVAN: Okay, thanks.

SENATOR STUHR: Are there others wishing to testify in a neutral capacity? If not, that closes the hearing on LB 503.